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SECURITIES AND EXCHANGE COMMISSION,	:
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Plaintiff,	:
	:
-against-	:
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ZURICH FINANCIAL SERVICES,	:
	:
Defendant.	:
-----X	:

USDC SDNY
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WILLIAM H. PAULEY III, District Judge:

¹ All capitalized terms not otherwise defined in this document shall have the meaning provided in the Distribution Plan.

On April 11, 2011, GCG moved to distribute the Fair Fund to Eligible Claimants. In that application, GCG sought \$528,673.88 in publication costs, \$455,471.35 in fees, and \$99,766.65 in expenses. By Memorandum & Order dated September 30, 2011 (the “September Order”), this Court found the fees and costs unjustified and the SEC’s oversight lacking. See SEC v. Zurich Fin. Servs., No. 08 Civ. 10760 (WHP), 2011 WL 4542892, at *5 (S.D.N.Y. Sept. 30, 2011).

In the September Order, this Court directed the SEC to, inter alia, justify the fees sought by GCG and explain why the publication costs were ten times higher than similar costs in the Converium class action. On October 28, 2011, the SEC reported that it had conducted a line by line review of GCG’s invoices. In its audit, the SEC uncovered a “discrepancy” in expenses relating to the purchase of print advertisements for the international notice program. Specifically, the SEC learned that GCG’s in-house advertising agency, GCG Communications, had charged an undisclosed 15% commission—\$77,953.27—to the Fair Fund for placing notices in print media. Following that revelation, this Court directed GCG to file a renewed motion to distribute the Fair Fund, consistent with the SEC’s response. In addition to seeking approval of the distribution plan, GCG now seeks \$469,442.11 in publication costs, \$492,533.77 in fees, and \$148,903.90 in expenses.

The amount of compensation to be awarded a court-appointed administrator is within the court's discretion. See SEC v. Byers, 590 F. Supp. 2d 637, 644 (S.D.N.Y. 2008). In evaluating GCG’s request for fees and expenses, this Court considers, among other factors: (1) the time and labor expended by the administrator; (2) the magnitude and complexities of the action; (3) the quality of the administration; (4) the requested fee in relation to the fund; and (5)

public policy considerations. See Goldberger v. Intergrated Res., Inc., 209 F.3d 43, 50 (2d Cir. 2000); see also United States v. Code Prods. Corp., 362 F.2d 669, 673 (3d Cir. 1966) (“In allowing fees the considerations are the time, labor and skill required, but not necessarily that actually expended, in the proper performance of the duties imposed by the court upon the receivers, the fair value of such time, labor and skill measured by conservative business standards, the degree of activity, integrity and dispatch with which the work is conducted and the result obtained.”). Further, “courts have recognized that it is unrealistic to expect a trial judge to evaluate and rule on every entry in an application.” N.Y. State Ass’n for Retarded Children, Inc. v. Carey, 711 F.2d 1136, 1146 (2d Cir. 1983); see also United States ex rel. Miller v. Bill Harbert Int’l. Constr. Inc., 601 F. Supp.2d 45, 50 (D.D.C. 2009) (“[T]he Court can also reduce fees by a reasonable amount without providing an item-by-item accounting[.]”).

In its renewed motion, GCG acknowledges that the undisclosed commission was not an actual out-of-pocket publication cost. Rather, it was additional compensation to be paid to GCG. While GCG claims that the commission it charged is “standard in the industry,” it offers nothing more than its ipse dixit as to why this is so. More importantly, GCG provides no explanation why that compensation was never disclosed to the SEC or this Court. By embedding the commission as an expense, GCG caused the SEC to make a misleading representation that GCG’s fees, exclusive of publication costs and other expenses, would be capped at \$375,000. This Court appointed GCG as administrator based in part on that inaccurate representation. Moreover, this Court would never have approved the publication program had GCG disclosed that it was deriving additional compensation from the undisclosed commission.

In its first application to distribute the Fair Fund, GCG sought reimbursement of

publication costs of \$528,673.88, nearly \$78,000 of which was a commission not paid to publishers, but instead to one of GCG's captives, i.e., its in-house advertising agency. GCG claims that such a commission is akin to one paid to a travel agent by an airline and not the ultimate ticket purchaser. But that facile comparison ignores the fact that GCG invoiced the full \$528,673.88—including GCG's \$78,000 commission—to the SEC, to be paid out of the Fair Fund.

This time around, GCG has withdrawn its \$78,000 commission from the application for publication costs. Needless to say, this Court would not have approved GCG's application had the embedded commission been included. However, GCG now seeks an additional \$18,721.50 in fees, for 138 hours of unbilled work purportedly performed by GCG employees on the publication program. Incredibly, the SEC does not object to this additional fee request because GCG's in-house advertising subsidiary secured a discount off the retail advertising rate. But neither the SEC nor GCG attempts to explain whether the discount GCG obtained was a reasonable result.

While acquiescence by the SEC to a fee application is usually accorded deference, see Byers, 590 F. Supp. 2d at 644, this Court cannot countenance the SEC's go-along attitude here. As Administrator, GCG owes a duty to distribute the fund efficiently. Industry standard or not, the undisclosed commission to GCG amounted to a kickback. The SEC has recommended appointment of GCG as fund administrator in many other actions around the country. See, e.g., SEC v. Nortel Networks Corp., No. 07 Civ. 8851 (LAP) (S.D.N.Y.); SEC v. Bristol-Myers Squibb Co., 04-CV-3860 (D.N.J.); SEC v. McAfee, Inc., 06-009 (PJH) (N.D. Cal.); SEC v. Tenet Healthcare Corp., et al., CV-07-2144 RGK (AGR) (C.D. Cal.). This Court wonders how

many embedded and undisclosed commissions GCG has received while administering the distribution of other monetary settlements obtained by the SEC.

Indeed, the SEC has punished similar behavior by mutual fund advisors who retained the benefit of service provider discounts instead of passing those savings to their client funds. See, e.g., Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Mgmt. LLC, 595 F.3d 86, 91 (2d Cir. 2010) (discussing the SEC's imposition of a \$200 million fine and disgorgement against fund advisors for a scheme that resulted in unnecessarily high expenses to mutual funds and undisclosed profits to fund advisors). While the magnitude of the scheme in Smith Barney was far greater than GCG's dealings here, the unsavory character is the same. Accordingly, GCG's request for fees of \$18,721.50 in connection with the publication program is denied.

GCG and the SEC proposed a cap of \$375,000 in fees for the administrator's services. The proposal did not include a budget describing the anticipated costs per claim. GCG now requests payment of \$492,533.77 in fees, an amount far in excess of the agreed cap under the distribution plan.² The SEC argues that exceeding the cap by \$117,533.77 is justified because the original cap was based on mailing 30,000 claim packets, and GCG mailed more than 55,000. But the cap was also based on GCG processing 6,000 claims, and GCG ultimately processed fewer than 4,400 claims. While mailing more claim packets undoubtedly increased

² \$28,537.50 of GCG's fees is attributed to work GCG performed in connection with an independent audit by EisnerAmper LLP ("Eisner"). The SEC agreed in the Distribution Plan that these fees would not be subject to the \$375,000 cap. Interestingly, Eisner's independent audit sampled only fifty-two claims. For that, Eisner received a fee of \$50,000 and GCG billed an additional \$28,537.50. This Court presumes that the SEC scrutinized the audit and concluded that \$78,537.50 was a reasonable sum to check fifty-two claims. But it is hard to tell from the SEC's submissions.

some back-office work, the more labor-intensive step of processing claims should have been significantly less time-consuming than GCG anticipated. Moreover, neither the SEC nor GCG sought this Court's approval to alter the distribution plan in such a manner. While GCG sent out approximately 80% more claim packets than anticipated, it processed 25% fewer claims than budgeted. Accordingly, this Court allows \$403,537.50 in fees (\$375,000 cap and \$28,537.50 to help with the Eisner audit) and denies the additional \$88,996.27 in fees that were unauthorized. This Court also allows GCG's expenses of \$148,903.90 and grants the remainder of GCG's distribution motion.

Ultimately, the distribution to aggrieved investors in this action has been delayed for sixteen months because GCG and the SEC tethered fees and expenses to the distribution to aggrieved investors. The SEC has allowed its responsibility to conduct meaningful oversight to fall to this Court. In order to foster the speedy dissemination of future Fair Funds, the SEC should create realistic fee and cost reserves and avoid tying distributions to the payment of fund administrators. In addition, the SEC should consider requiring fund administrators to certify that all fees and expenses were reasonable and that no funds are being distributed to persons or entities who participated in the underlying wrongdoing or who are otherwise conflicted from receiving any benefits from the SEC. The SEC should also certify to courts that it has reviewed every line item, and that each of the fees and expenses sought by a plan administrator were necessary and appropriate to fulfill the distribution plan's objectives. If the SEC is serious about compensating aggrieved investors, it should take a much harder look at the submissions of its fund administrators. And no fund administrator should ever be authorized to speak on behalf of the SEC or to represent to a court that the SEC has no objection to the fund administrator's

application. As the party before the Court and an agency of the Government, the SEC should state its own position directly and unequivocally.

Accordingly, this Court orders the following:

1. The Clerk of the Court shall disburse the full principal and interest of the Fair Fund from the Court Registry Investment System ("CRIS") account for this action to the Fair Fund Escrow Account, maintained at Signature Bank, QSF SEC v. Zurich Financial Services Distribution Fund, as custodian for the distributions of the Zurich Financial Distribution Plan and established pursuant to Section 3.30 of the Distribution Plan. The Clerk of the Court is directed to issue a check for the full balance of the CRIS account payable to QSF SEC v. Zurich Financial Services Distribution Fund. The Clerk of the Court shall deliver the check via Federal Express to:

Signature Bank
1225 Franklin Avenue
Garden City, NY 11530
Attention: Stephen Reinhardt

The CRIS account shall be closed, and GCG will supply a copy of the receipt to counsel for the SEC within ten days of the receipt of the monies.

2. GCG is authorized to pay itself \$1,003,162.01 from the Fair Fund, which represents GCG's actual out-of-pocket costs for the publication program (\$450,720.61), the agreed fee cap of (\$375,000), the fees accrued in connection with the independent audit (\$28,537.50), and GCG's expenses (\$148,903.90) incurred from the inception of this matter through February 29, 2012.

3. A reserve shall be established by GCG in the amount of \$100,000 to accommodate final fees and expenses incurred in the administration, fees related to work

performed by Damasco & Associates, LLP (“Damasco”), any applicable tax liabilities, and to cover any claims that require adjustment if approved by the Court (the “Reserve”).

4. The Court approves all properly supported late claims filed on or before July 20, 2012. Any Claim received by GCG after July 20, 2012 is barred.

5. GCG is authorized to distribute the monies in the Fair Fund Escrow Account less the \$100,000 Reserve and the \$1,003,162.01 in GCG’s fees, costs and expenses (the “Available Distribution”), to Eligible Claimants and approved late claimants on a pro rata basis as calculated pursuant to Section 2.3 of the Distribution Plan and as set forth in Exhibit 3 to the Affirmation of Stephen J. Ciriame in Support of the Second Motion for Distribution of Fair Fund (the “Approved Claims”). No payment shall be made in respect of the 2,989 claims that were rejected by GCG.

6. GCG shall distribute the Available Distribution by mailing checks or wire transferring funds to all Eligible Claimants or their authorized representatives in the amount of the Approved Claims. GCG is directed to submit a report and certify that it has made the initial distribution to Eligible Claimants and approved late claimants by September 28, 2012. GCG is further directed to submit a report by December 28, 2012, stating the amount of funds remaining in the Escrow Account, the number of uncashed checks, and the approximate costs of distributing any remaining funds to aggrieved investors.

7. All physical documents, including Proof of Claim forms, claimant correspondence, relevant databases, and CDs, are to be retained for one year beyond the date of distribution, after which time all physical documents may be destroyed. Electronic versions of the claims database will be stored in a secure off-site facility and retained for an additional three


years, after which time they may be destroyed.

8. GCG is authorized to make an application for further distributions from the Reserve to pay additional fees and expenses of the Claims Administrator, and adjusted claims, if approved by the Claims Administrator, and to pay tax liabilities and fees of the Tax Administrator, in accordance with Section 5.2 of the Distribution Plan.

9. By June 28, 2013, and subject to this Court's prior approval, the balance of the unused Reserve as well as the amount of un-cashed checks shall be paid to the SEC for transfer to the U.S. Treasury, in accord with Section 2.6 of the Distribution Plan.

Dated: August 21, 2012
New York, New York

SO ORDERED:


WILLIAM H. PAULEY III
U.S.D.J.

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